



*The Management's Discussion and Analysis provides a narrative overview and analysis of the financial activities of the State.*

# Management's Discussion and Analysis

The following is a discussion and analysis of the State of Missouri's (the State's) financial activities for the fiscal year ended June 30, 2005. Readers are encouraged to consider the information presented here in conjunction with additional information that is furnished in the letter of transmittal.

## HIGHLIGHTS

### Government-Wide:

- Assets of the State's governmental activities exceeded liabilities by \$27.4 billion; however this represents a decrease in net assets of \$92.2 million or 0.34% from the prior year. This decrease can be accounted for by an increase in accounts payable of \$115.6 million, an increase in long-term liabilities of \$42.3 million (primarily leases and claims liabilities), and a decrease in capital assets of \$36.1 million.
- Liabilities of the State's business activities exceeded assets by \$71 million; however this represents an increase in net assets of \$18.6 million or 20.75% from the prior year. This increase can be explained primarily by a significant decrease to unemployment compensation benefits.

### Fund-Level:

- Governmental fund assets exceeded liabilities by \$3.1 billion, a decrease of \$291.2 million or 8.66% from the prior year. The decrease was primarily due to the increase of \$389.6 million in liabilities from which \$252.9 million were deferred revenue.

### Debt Issued and Outstanding:

- The primary government's total long-term obligations related to bonds payable decreased \$115.7 million or 4.66% over the prior year. The outstanding bonds payable represents 41.0% of financial assets (cash, receivables, and investments) and 7.10% of total assets. The net decrease in bonds payable resulted from decreases of \$107,070,000 due to bond payments and \$166,250,000 due to bond refundings and increases of \$157,605,000 due to issuances of General Obligation, State Road, and Other Bonds. Additional detail is available in *Note 12*.

### Revenue Limit:

- The State Constitution limits the State's ability to retain revenue collected over an amount set by a constitutional amendment known as Article X or the Hancock Amendment. Excess revenue must be refunded to the taxpayers each year. During fiscal year 2005, the State did not exceed the revenue limit.

## OVERVIEW OF THE FINANCIAL STATEMENTS

The State's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

### Government-Wide Financial Statements:

The government-wide financial statements are designed to provide readers with a broad overview of the State's finances, in a manner similar to a private-sector business.

The *Statement of Net Assets* presents information on all of the State's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of the State's financial position.

The *Statement of Activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of when the cash is received. Thus, revenues and expenses are reported in the statement for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements report three activities:

*Governmental Activities* are primarily supported by taxes and intergovernmental revenues. They include general government, education, natural and economic resources, transportation and law enforcement, and human services.

*Business-Type Activities* are intended to recover all or a significant portion of their costs through user fees and charges. They include constructing and operating state park facilities, fairgrounds, historical properties and office buildings, hospital services, warehousing, merchandising, publishing maps and documents, insurance coverage, and the operation of the State Lottery, Unemployment Compensation, and the Petroleum Storage Tank Insurance funds.

*Discretely Presented Component Units* are operations for which the State has financial accountability, but are legally separate. They include colleges and universities, the Missouri Development Finance Board, Agricultural and Small Business Development Authority, and various highway transportation corporations.

### **Fund Financial Statements:**

The fund financial statements present more detail about the government's operations than the government-wide statements. The State uses fund accounting to ensure and demonstrate compliance with statutory requirements. All of the funds of the State can be divided into three categories: governmental, proprietary, and fiduciary funds.

*Governmental funds* are used to account for most of the basic services provided by the State. Unlike the government-wide financial statements, governmental fund financial statements focus on short-term inflows and outflows of current financial resources and utilize the modified accrual basis of accounting. This presentation focuses on when cash will be received and disbursed making the statements useful in evaluating a government's financing requirements in the near future.

Governmental funds include the general, special revenue, capital projects, debt service, and permanent funds. Major Funds include general, public education, conservation and environmental protection, transportation and law enforcement, and the State Road Fund which are presented in separate columns. Data from other governmental funds are combined into a single column for aggregated presentation. Individual fund data for each of these non-major governmental funds is provided in the form of combining statements.

In order for the user to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements, a reconciliation to facilitate this comparison is provided on the page immediately following each governmental fund financial statement.

*Proprietary funds.* Proprietary funds are used to account for activities similar to private businesses in which goods and services are sold for specified fees. Generally, the State uses enterprise funds to account for activities that provide goods and services to the general public. These include constructing and operating state park facilities, fairgrounds, historical properties and office buildings, hospital services, warehousing, merchandising, publishing maps and documents, and the operation of the State Lottery, Unemployment Compensation, and the Petroleum Storage Tank Insurance funds. Internal service funds report activities that provide supplies and services for the State's other programs and activities. The State uses internal service funds to account for insurance and health-care plans, as well as administrative services for other state agencies, such as fleet management, data processing, and telecommunication services. Because these services predominately benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements.

Proprietary funds focus on economic resources and utilize the full accrual basis of accounting. The proprietary fund financial statements provide separate information for the State Lottery, Unemployment Compensation, and Petroleum Storage Tank Insurance, which are considered major enterprise funds. All internal service funds are combined into a single column in the proprietary fund financial statements. Non-major enterprise funds are combined into a single column for aggregated presentation. Individual fund data for the non-major enterprise and internal service funds is provided in the form of combining statements in supplementary information.

*Fiduciary funds.* Fiduciary funds are used to account for resources held for the benefit of parties outside the state government. Fiduciary funds are *not* reflected in the government-wide financial statements because the resources of those funds are not available to support the State's own programs. The accounting used for fiduciary funds is similar to that used for proprietary funds.

**Notes to the financial statements.** The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

**Other information.** In addition to the basic financial statements and accompanying notes, this report also presents required supplementary information (RSI) including a budgetary comparison schedule for the general fund and major special revenue funds. Other supplementary information includes the combining statements for the general, non-major governmental, non-major enterprise, internal service, fiduciary, and non-major component unit funds. It also includes the statistical section as well as budgetary comparison schedules for the State Road, non-major special revenue, debt service, and permanent funds.

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

### Net Assets:

The following table displays the current and prior year government-wide condensed Statement of Net Assets.

STATEMENT OF NET ASSETS						
(In Thousands of Dollars)						
	Governmental Activities		Business-Type Activities		Total	
	2005	2004*	2005	2004*	2005	2004*
<b>ASSETS:</b>						
Current and Other Assets	\$ 5,465,458	\$ 5,350,225	\$ 426,345	\$ 400,457	\$ 5,891,803	\$ 5,750,682
Capital Assets, Net	27,396,609	27,432,714	39,053	39,601	27,435,662	27,472,315
<i>Total Assets</i>	<u>32,862,067</u>	<u>32,782,939</u>	<u>465,398</u>	<u>440,058</u>	<u>33,327,465</u>	<u>33,222,997</u>
<b>LIABILITIES:</b>						
Other Liabilities	1,378,000	1,248,997	302,782	305,120	1,680,782	1,554,117
Long-Term Liabilities						
Outstanding	4,074,019	4,031,712	233,646	224,574	4,307,665	4,256,286
<i>Total Liabilities</i>	<u>5,452,019</u>	<u>5,280,709</u>	<u>536,428</u>	<u>529,694</u>	<u>5,988,447</u>	<u>5,810,403</u>
<b>NET ASSETS:</b>						
Invested in Capital Assets,						
Net of Related Debt	25,486,977	25,476,294	39,053	38,266	25,526,030	25,514,560
Restricted	3,208,685	3,257,562	12,407	13,673	3,221,092	3,271,235
Unrestricted	(1,285,614)	(1,231,626)	(122,490)	(141,575)	(1,408,104)	(1,373,201)
<i>Total Net Assets</i>	<u>\$ 27,410,048</u>	<u>\$ 27,502,230</u>	<u>\$ (71,030)</u>	<u>\$ (89,636)</u>	<u>\$ 27,339,018</u>	<u>\$ 27,412,594</u>
*Fiscal year 2004 amounts have been restated.						

The State's total net assets decreased \$73.6 million or 0.27% during fiscal year 2005. This decrease resulted primarily from an increase of \$178.0 million in liabilities. Capital assets net of related debt and restricted assets, which do not represent resources available to pay day-to-day operating expenses, decreased by \$38.7 million or 0.13%.

The largest component of the State's net assets at \$25.5 billion or 93.37% is invested in capital assets net of related debt, such as bonds payable or capital lease obligations. These assets include land, infrastructure, buildings, and equipment which are not easily converted to cash nor readily available to pay state debts as they come due.

Restricted net assets of the primary government totaled \$3.2 billion or 11.78% of total net assets, vs. 11.93% from the prior year. Net assets are restricted for several reasons including constitutional, legal, or external requirements. Examples of restricted net assets include lottery proceeds restricted for public education, funds restricted for debt service, and certain sales taxes restricted for the maintenance of highways or state parks and conservation areas. Also, many federal funds are restricted to funding certain programs.

### Changes in Net Assets:

The following table displays the current and prior year government-wide condensed Statement of Activities.

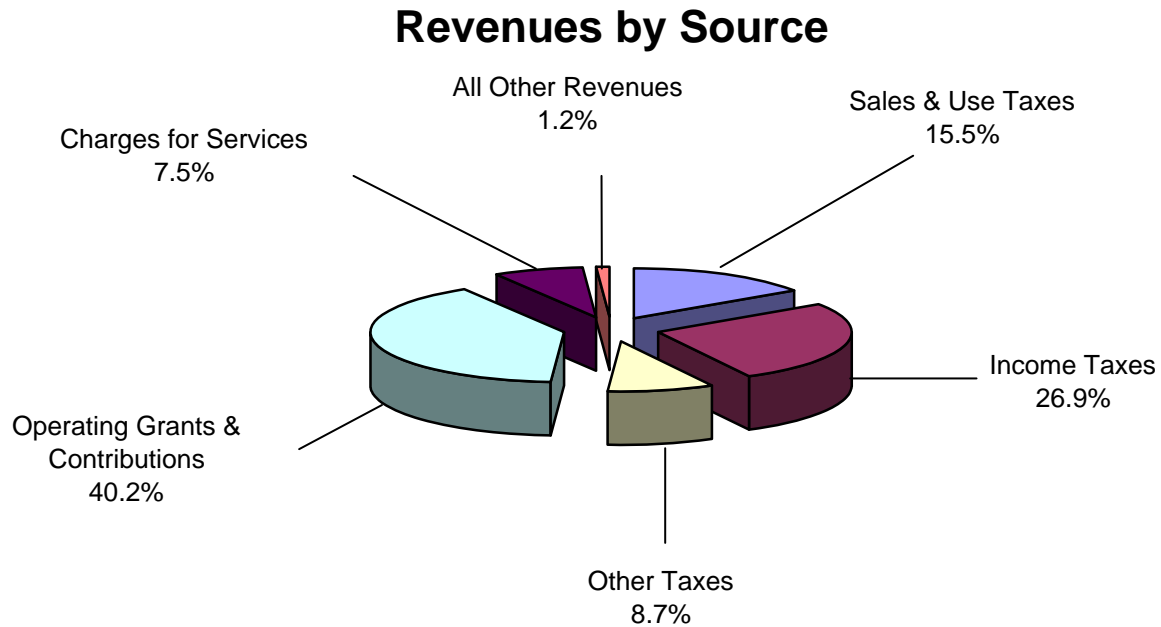
<b>STATEMENT OF ACTIVITIES</b>						
(In Thousands of Dollars)						
	Governmental Activities		Business-Type Activities		Total	
	2005	2004*	2005	2004*	2005	2004*
<b>REVENUES:</b>						
Program Revenues:						
Charges for Services	\$ 1,450,194	\$ 1,446,601	\$ 855,468	\$ 861,917	\$ 2,305,662	\$ 2,308,518
Operating Grants and Contributions	7,767,844	7,328,176	544,697	538,949	8,312,541	7,867,125
General Revenues:						
Sales and Use Taxes	3,003,405	2,827,294	---	---	3,003,405	2,827,294
Income Taxes	5,172,616	4,713,162	---	---	5,172,616	4,713,162
Unemployment and Other Taxes	1,686,767	1,598,491	---	---	1,686,767	1,598,491
Other Revenues	237,680	66,827	3,951	(5,722)	241,631	61,105
<i>Total Revenues</i>	<u>19,318,506</u>	<u>17,980,551</u>	<u>1,404,116</u>	<u>1,395,144</u>	<u>20,722,622</u>	<u>19,375,695</u>
<b>EXPENSES:</b>						
General Government	754,664	719,349	---	---	754,664	719,349
Education	5,669,602	5,377,304	---	---	5,669,602	5,377,304
Natural and Economic	624,461	1,030,696	---	---	624,461	1,030,696
Transportation and Law Enforcement	2,009,647	1,737,859	---	---	2,009,647	1,737,859
Human Services	9,731,318	8,830,104	---	---	9,731,318	8,830,104
State Lottery	---	---	575,678	575,071	575,678	575,071
Unemployment Compensation	---	---	501,098	695,647	501,098	695,647
Petroleum Storage Tank	---	---	25,916	12,281	25,916	12,281
Veterans' Homes	---	---	58,745	51,962	58,745	51,962
All Other Expenses	828,155	838,572	16,914	15,947	845,069	854,519
<i>Total Expenses</i>	<u>19,617,847</u>	<u>18,533,884</u>	<u>1,178,351</u>	<u>1,350,908</u>	<u>20,796,198</u>	<u>19,884,792</u>
Excess (Deficiency) of Net Assets before Transfers	(299,341)	(553,333)	225,765	44,236	(73,576)	(509,097)
<i>Transfers</i>	<u>207,159</u>	<u>219,003</u>	<u>(207,159)</u>	<u>(219,003)</u>	<u>---</u>	<u>---</u>
Change in Net Assets	(92,182)	(334,330)	18,606	(174,767)	(73,576)	(509,097)
<i>Beginning Net Assets</i>	<u>27,502,230</u>	<u>27,836,560</u>	<u>(89,636)</u>	<u>85,131</u>	<u>27,412,594</u>	<u>27,921,691</u>
<i>Ending Net Assets</i>	<u>\$ 27,410,048</u>	<u>\$ 27,502,230</u>	<u>\$ (71,030)</u>	<u>\$ (89,636)</u>	<u>\$ 27,339,018</u>	<u>\$ 27,412,594</u>
*Fiscal year 2004 amounts have been restated.						

As shown on the above schedule, total revenue collections increased by \$1.3 billion or 6.95% during fiscal year 2005. Total expenses increased by \$911.4 million or 4.58% during fiscal year 2005. Those functions with the largest percentage increase include Human Services with 46.79% of total expenses in 2005 vs. 44.41% of total expenses in 2004 and Transportation and Law Enforcement with 9.66% of total expenses in 2005 vs. 8.74% of total expenses in fiscal year 2004.

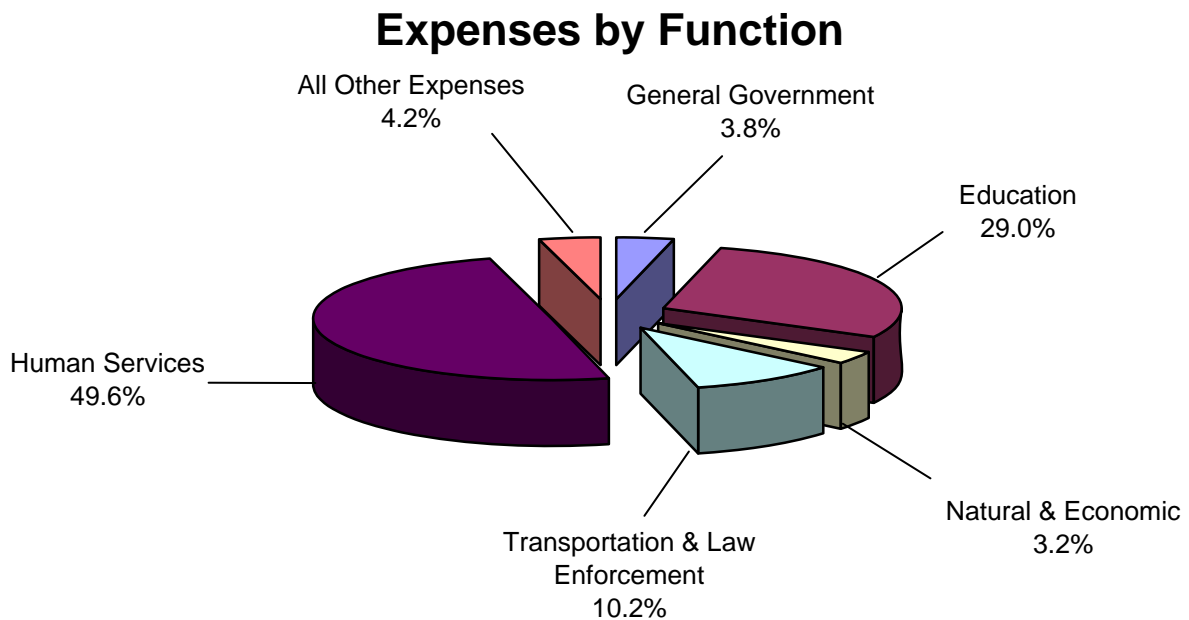
### Governmental Activities:

Governmental activities decreased the State's net assets by \$92.2 million due primarily to the increase of \$1.1 billion in expenses of which \$901.2 million relates to the increase in human services expenses.

The following chart depicts revenues of the governmental activities for the fiscal year:



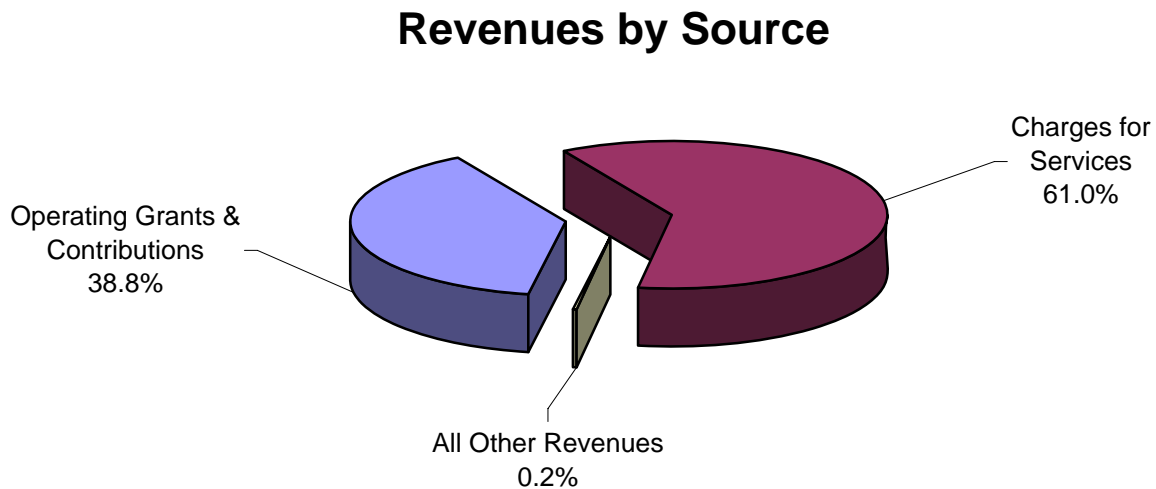
The following chart depicts expenses of the governmental activities for the fiscal year:



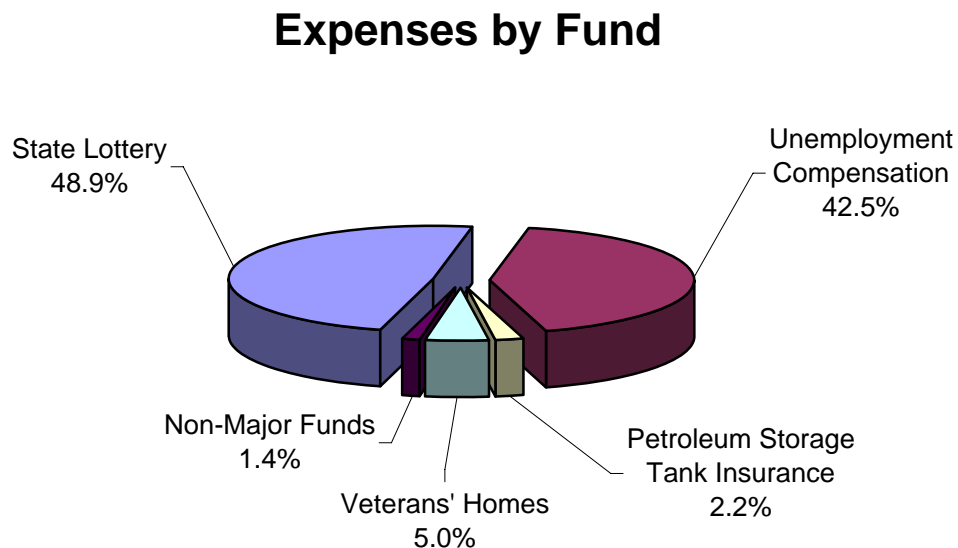
### Business-Type Activities:

Net assets of the business-type activities increased by \$18.6 million during the fiscal year due primarily to the increase of \$9 million in total revenues and to the decrease of \$172.5 million in total expenses.

The following chart depicts revenues of the business-type activities for the fiscal year:



The following chart depicts expenses of the business-type activities for the fiscal year:



## FUND STATEMENT ANALYSIS

### Governmental Funds:

At the end of fiscal year 2005, the State's governmental funds reported combined ending fund balances of \$3.1 billion, a decrease of \$291.2 million or 8.66% over fiscal year 2004. Approximately 52.63% is unreserved and available for spending at the government's discretion. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed: 1) for budget reserve, 2) to pay debt service, 3) for loans receivable, and 4) for a variety of other purposes.

Fund balances (in thousands) for governmental funds are as follows:

	General Fund	Public Education	Conservation and Environmental Protection	Transportation and Law Enforcement	State Road	Non- Major	Total
Unreserved	\$ 326,907	\$ 229,885	\$ 386,770	\$ 187,699	\$ 120,202	\$ 364,518	\$ 1,615,981
Reserved	577,561	46	604,357	6,950	111,007	154,499	1,454,420
<b>Total</b>	<b>\$ 904,468</b>	<b>\$ 229,931</b>	<b>\$ 991,127</b>	<b>\$ 194,649</b>	<b>\$ 231,209</b>	<b>\$ 519,017</b>	<b>\$ 3,070,401</b>

The General Fund is the chief operating fund of the State. At the end of fiscal year 2005, the State's General Fund reported a total fund balance of \$904.5 million. The net decrease in fund balance during fiscal year 2005 was \$270.6 million. Revenues of the general fund totaled \$14.8 billion in fiscal year 2005, an increase of \$892 million from fiscal year 2004. Factors contributing to this increase included the following:

- Revenue from taxes increased \$476.6 million from fiscal year 2004 to fiscal year 2005. The most significant increase was Individual Income Tax, which increased \$288.3 million, and an increase of \$63.1 million in revenue from sales and use tax.
- Contributions and intergovernmental revenues increased by \$398.7 million during fiscal year 2005 due primarily to an increase of \$514.3 million in revenue from federal receipts for grants or programs financed by the U.S. Department of Health and Human Services and a decrease of \$138.5 million from federal receipts for grants or programs financed by other federal sources.

Expenditures of the General Fund totaled \$12.7 billion in fiscal year 2005, an increase of \$1.2 billion from fiscal year 2004. The major factor that contributed to this was an increase of \$937.3 million to human services expenditures due primarily to two factors:

- An increase of \$138.6 million paid to individual recipients for social welfare.
- An increase of \$471 million in payments to doctors, hospitals, consultants and optical companies, and similar institutions who also provide medical treatment to social welfare recipients.

The public education fund category provides general and special education services to the children of the State and other related functions such as library services and student loans. Total fund balance increased by \$32.3 million. Expenditures of the public education funds totaled \$3.8 billion in fiscal year 2005, an increase of \$156.1 million from fiscal year 2004. The major factor that contributed to this was an increase of \$143.7 million in the education expenditures for an increase in aid to educational institutions and school districts for expenditures by the institution or the district.

The conservation and environmental protection fund category provides for the preservation of the State's wildlife and environment. The fund balance increased by \$52 million. Revenues of the conservation and environmental protection funds totaled \$321 million for fiscal year 2005, a decrease of \$21.7 million from fiscal year 2004. The major contributing factor is a decrease of \$31 million in contributions and intergovernmental revenues due mainly to a decrease of \$34.5 million in federal receipts for grants or programs financed by the U.S. Environmental Protection Agency and an increase of \$3 million in revenue from conservation sales and use tax.



Expenditures of the conservation and environmental protection funds totaled \$272 million for fiscal year 2005, an increase of \$4.1 million. The major factor that contributed to this was an increase of \$61.4 million in natural and economic resources and a decrease of \$47.7 million in intergovernmental expenditures.

The transportation and law enforcement fund category provides transportation services, road construction and maintenance, and the enforcement of vehicle laws and traffic safety. The fund balance increased by \$62.3 million. Revenues increased \$24.5 million during fiscal year 2005. The major factor contributing to this was an increase of \$15.6 million in revenue from license fees and permits. Out of this amount, \$3 million is revenue from motor vehicle license and permits and \$2 million is in the form of charges to owners and operators of motor vehicle and trailers operated in interstate or combined interstate/intrastate commerce.

The State Road Fund accounts for revenues from highway users' fees, federal reimbursements for highway projects, and bond proceeds to be used for costs of constructing and maintaining an adequate state highway system. The fund balance decreased by \$98.7 million in fiscal year 2005. Revenues of the State Road Fund increased during fiscal year 2005 by \$127.1 million primarily due to an increase of \$108.2 million in revenues from contributions and intergovernmental. Out of this amount, \$95.5 million are from federal receipts for grants or programs financed by the U.S. Department of Transportation.

#### **Proprietary Funds:**

The State has three major proprietary funds: State Lottery, Unemployment Compensation, and the Petroleum Storage Tank Insurance Fund. The State Lottery was established in 1986 to account for the sale of lottery tickets and lottery operations. Since 1992, public education has been the sole beneficiary of lottery proceeds. Unemployment Compensation accounts for contributions and payments collected from Missouri employers under the provision of the "Unemployment Compensation Law". This tax finances benefits for workers who become unemployed through no fault of their own. The Petroleum Storage Tank Insurance Fund accounts for moneys collected from transport load fees and participating owners of petroleum storage tanks. The fund pays cleanup expenses from petroleum leaks or spills from underground storage tanks and certain above ground storage tanks as well as third party property damage or bodily injury resulting from such discharges. This fund is one of the largest insurers of tanks in the country.

The State Lottery Fund's net assets increased by \$630,000. Revenues decreased by \$5.9 million during the year because of the decrease of \$5.6 million in lottery ticket sales.

The Unemployment Compensation Fund's net assets increased by \$18.3 million due primarily to a decrease of \$194.5 million in unemployment benefit expenses.

The Petroleum Storage Tank Insurance Fund's net assets increased by \$946,000. Expenses increased by \$13.8 million primarily due to an increase of \$13.4 million in specific programs.

#### **GENERAL FUND BUDGETARY HIGHLIGHTS**

The original budget is the first complete appropriated budget that is truly agreed to and finally passed, and signed by the Governor. The final budget includes emergency and supplemental appropriations, transfers, and increases to estimated appropriations.

Budgeted appropriations for fiscal year 2005 from the general fund were \$16.6 billion original budget and \$17 billion revised budget. Actual spending was \$15.9 billion. Reasons for the budget variances include:

- Federal grants received were lower than appropriation authority.
- Multiple year grants are appropriated in one year but the expenditures may occur over several years.
- Appropriation authority exceeded cash available for expenditures.
- Federal moneys related to Medicaid were lost because the Department of Social Services did not have available the money for the required state match.

Budgeted revenues/transfers in for fiscal year 2005 for the general fund was \$15.6 billion original budget and \$15.6 billion revised budget. Actual revenue/transfers in was \$15.7 billion. Reasons for the budget variances include:

- Revenue growth in fiscal year 2005 outpaced economic growth forecasts for the State. Many economic forecasting experts predicted strong growth in production, but slow growth in jobs. Since Missouri's revenues are highly dependent on withholding and sales taxes, continued conservatism in the forecast was justified.
- Tax changes at the Federal level, particularly the Jobs and Growth Tax Relief Reconciliation Act of 2003, created uncertainty and posed substantial downside risk. While some provisions of the Act benefited Missouri's revenues, the Act also raised the standard deduction for many filers and enhanced depreciation allowances.

Refer to the *Notes to RSI*, Budgetary Reporting, on page 92 for more information on budgetary variances.

## CAPITAL ASSET AND DEBT ADMINISTRATION

### Capital Assets:

The State's investment in capital assets for its governmental and business-type activities as of June 30, 2005, was \$27.4 billion (net of accumulated depreciation). This investment in capital assets includes construction in progress, infrastructure in progress, land, land improvements, buildings and improvements, equipment, and infrastructure.

### Capital Assets of the State include (in thousands):

	Governmental Activities	Business-Type Activities	Total
Construction in Progress	\$ 440,480	\$ 5,836	\$ 446,316
Infrastructure in Progress	3,046,299	---	3,046,299
Land	2,400,996	5,748	2,406,744
Land Improvements	137,088	4,818	141,906
Buildings and Improvements	2,046,814	26,069	2,072,883
Equipment	1,116,926	46,569	1,163,495
Infrastructure	38,064,362	---	38,064,362
<i>Subtotal</i>	47,252,965	89,040	47,342,005
Less Accumulated Depreciation	(19,856,356)	(49,987)	(19,906,343)
<b><i>Total Capital Assets, Net</i></b>	<b>\$ 27,396,609</b>	<b>\$ 39,053</b>	<b>\$ 27,435,662</b>

Additional information on capital assets can be found in *Note 5* of this report.

### Long-Term Debt:

At the end of fiscal year 2005, the State had total general obligation and other bonded debt outstanding of \$2.4 billion. Of this amount, \$790.9 million comprises debt backed by the full faith and credit of the government.

During fiscal year 2005, \$157,605,000 of general obligation refunding bonds were issued to refund \$166,250,000 of general obligation bonds and to take advantage of lower interest rates. Principal amounts retired in fiscal year 2005 were \$55,560,000 for general obligation bonds and \$51,510,000 for other revenue bonds.

The State of Missouri is proud to be one of only six states to maintain a Triple-A credit rating from all three major credit rating agencies (Moody's Investor Services, Inc., Standard and Poor's, and Fitch Ratings, Inc.) on the State's General Obligation Bonds.

**Outstanding Bonds Payable of the State include (in thousands):**

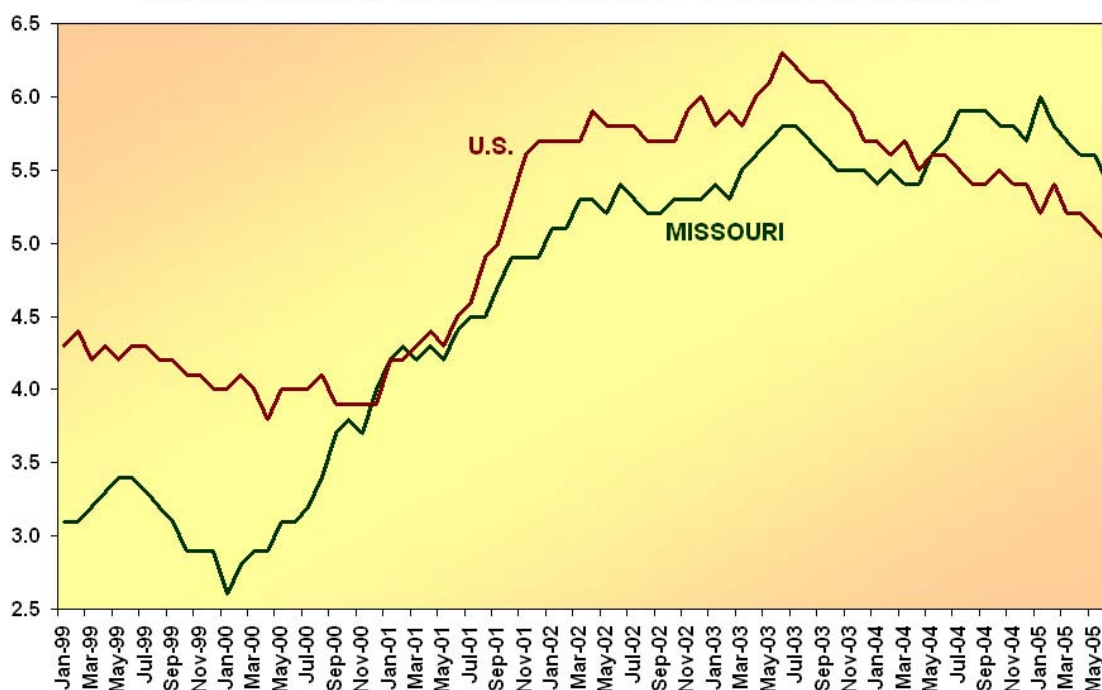
	Governmental Activities	Component Units	Total
General Obligation Bonds	\$ 790,910	\$ ---	\$ 790,910
Other Bonds	1,577,000	1,005,041	2,582,041
<b>Total</b>	<b>\$ 2,367,910</b>	<b>\$ 1,005,041</b>	<b>\$ 3,372,951</b>

Additional information on long-term debt can be found in *Notes 11, 12, and 13* of this report.

**ECONOMIC OUTLOOK AND NEXT YEAR'S BUDGET**

Missouri's economic future remains positive as evidenced by economic indicators and statistics. Missouri's exports totaled approximately \$9.7 billion in fiscal year 2005 which is nearly a half a billion ahead of the record sales of fiscal year 2004. Missouri ranked No. 21 nationally in personal income growth with an increase of 1.1% from the fourth quarter of 2004 to the first quarter of 2005. This outpaced the national average of 0.7%. Cost of living in Missouri is the 6th lowest in the nation and the Purchaser Manager's Index (PMI) for June was 56. A score of above 50 indicates an expanding economy.

**U.S. AND MISSOURI UNEMPLOYMENT RATE, SEASONALLY ADJUSTED**



Source: MERIC & U.S. Bureau of Labor Statistics

After fairly irregular employment growth in 2004, Missouri's employment is beginning to show strong growth in 2005. Approximately 39,700 jobs have been added to Missouri's economy, on a seasonally adjusted basis, representing an annual growth rate of about 3.5%. During that period, all major industry groups, except "other services" and government expanded; private sector industry employment increased by 42,800 jobs between January and June of this year.

During fiscal year 2005, Missouri's unemployment rate peaked in January at 6%. Since then, the unemployment rate has been decreasing, dropping to 5.4% in June. This is a 0.3% decrease from the end of June in fiscal year 2004 and the lowest the unemployment rate has been since February 2003 when it was 5.3%. Historically, Missouri's unemployment rate has been lower than the nation's rate and has mirrored its changes. However, since June 2004, Missouri's unemployment rate has exceeded the U.S. unemployment rate, thanks in part to a growing labor force.

The State of Missouri completed fiscal year 2005 with a growth in revenues of 5.8% from fiscal year 2004 and a balanced budget. Balancing the budget included cuts in the state workforce of 1,456 positions, debt management, and a reduction to Medicaid. However, significant funding challenges are still on the horizon involving education, Medicaid, and correctional facilities.

Funding for Missouri schools remains a challenge. Elementary and secondary education became the top public priority in 2005 with a revision of the school funding formula. This revision calls for an increase in spending by about \$800 million to be phased in by the 2012-13 school year. This revision came in response to a lawsuit filed by 257 of the 524 Missouri schools against the State in January 2004 over both the equity of funding between schools and the overall adequacy of school funding. An amended lawsuit filed in November 2005, by 231 of the schools is still pending. In fiscal year 2006, lawmakers have increased education spending by 4.4% or \$158 million.

State universities and community colleges have experienced several substantial funding cuts during past years. In the last two years, tuition has increased by 23.8% for four-year institutions and 16.2% at community colleges. However, the level of funding for higher education will remain the same for 2006 as it was for 2005.

The percentage growth for Medicaid is expected to continue to outpace growth in general revenue for fiscal year 2006. In response, the State has implemented changes in order to sustain the program, including reducing the income eligibility levels and certain optional services for the working disabled and general relief medical assistance programs and reverification of eligibility. The Medicaid Reform Commission was also formed with the purpose of making recommendations to the General Assembly on redesigning, reforming, or restructuring a new Medicaid system to be enacted on June 30, 2008. These changes impact 90,000 Missourians and will cut approximately \$474 million dollars from Medicaid in fiscal year 2006.

Tougher crime laws have made it increasingly costly for the State's correctional facilities. The prison population has doubled since 1990 to around 31,000 inmates. The cost of maintaining these facilities has also doubled to a total of \$589 million in fiscal year 2006. Rising costs and budgetary pressures have led to the closing of several inefficient state prisons in fiscal year 2005 including the Missouri State Penitentiary, the Chillicothe Correctional Center, and Church Farm. Inmates at these closed prisons were moved to other correctional facilities.

Despite funding challenges, the State is working to stimulate the economy, increase efficiency, and decrease costs. In the past year, Missouri has passed Senate Bill 343 – the Missouri Quality Jobs Act which creates a new incentive program that rewards businesses for new jobs created, House Bill 393 – Tort Reform to address Missouri's medical malpractice insurance crisis and moderate the litigation environment, and Senate Bill 1 – Worker's Compensation Reform which creates a reasonable balance between the rights of workers to be compensated for their legitimate work-related injuries and the needs of businesses to have an affordable worker's compensation system. These measures should encourage economic development in Missouri, and benefit workers and employers alike.

Events taking place after the State's fiscal year end include:

- Information Technology Resources will be consolidated within the Office of Administration for a more effective use of state resources and lower cost.
- In November 2005, the Report and Recommendations of the Missouri State Government Review Commission will be issued. This report gives a comprehensive review of state government functions for the purpose of restructuring, consolidating, or eliminating these functions in order to provide better and more cost effective services to Missouri citizens.

## **REQUESTS FOR INFORMATION**

This financial report is designed to provide a general overview of the State's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the Office of Administration, Division of Accounting, P.O. Box 809, Jefferson City, MO 65102.